

LEGISLATION WATCH / MIDDLE EAST



Saudi Arabia Set to Welcome New Insolvency Law

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The Ministry of Commerce and Investment of the Kingdom of Saudi Arabia (the “**Ministry**”) is at the latter stages of its plan to introduce a new insolvency law. The Ministry published a policy paper in March 2015 setting out the framework and the main guiding principles of the new insolvency regime, received commentary on the policy paper and recently published a first draft of the proposed law (the “**Draft**”) in September 2016.

The current insolvency regime, which is detailed in Chapter 10 of the Saudi Commercial Court Law 32/1350 (the “**CCL**”) and the Royal Decree M/16 of 1416 (1996) on the Law of Settlement Preventing Bankruptcy, has generally been criticized as inadequate and a hindrance to economic activity and the revitalization of failing businesses. For example, the insolvency procedures prescribed in the CCL do not have much value in practice given that creditors are required to obtain an express admission of insolvency by the debtor or a final court judgment establishing that the debtor is insolvent in order to initiate the insolvency procedures, which renders the whole process inefficient. Moreover, the

existence of multiple sources of regulations pertaining to insolvency, which are often ambiguous and difficult to interpret, leads to a perception that the court’s application of the rules is highly discretionary.

The Ministry therefore set out to develop a modern, simple and coherent insolvency regime that primarily aims to encourage economic activity in the Kingdom of Saudi Arabia. The proposed regime benefits from a comparative analysis of the insolvency laws of Czech Republic, England and Wales, France, Germany, Japan, Singapore and the United States, drawing from the best practices in these jurisdictions, while taking into account local conditions and Shari’ah compliance. The proposed regime aims to encourage economic activity by favoring conciliation and rehabilitation over formal bankruptcy proceedings. The Ministry also hopes to develop a procedure that allows for an orderly liquidation of businesses, that is largely driven by creditors. To achieve these goals, the Draft proposes that the following procedures be made available to debtors and their creditors:



— **Protective settlement procedures:** a conciliation procedure that can be initiated by the court upon the request of either (i) debtors that are insolvent, in distress or likely to have difficulties repaying their debts, or (ii) the regulator of such debtor's activities. Under a protective settlement procedure, the debtor would be able to apply for a short stay (up to 90 days) against creditors' claims and could remain in possession of its assets. Debtors would also be permitted to obtain financing or new loans while the procedures are ongoing. Unlike the current Law of Settlement Preventing Bankruptcy, which does not distinguish between different classes of creditors, the protective settlement procedures provided for in the Draft allow for the categorization of creditors into different classes. Additionally, the proposed rules extend voting rights to creditors to approve debtors' proposals and allow the court to compel dissenting creditors to accept a debtor's proposal if two-thirds of the creditors accept such proposal.

— **Rehabilitation:** a newly introduced procedure that debtors, creditors or the regulator of a debtor's activities can commence when the debtor is in distress or insolvent. The procedure entails appointing a licensed insolvency professional, upon a formal judicial management/administration process, who will have broad powers in managing the assets of the debtor and will be responsible for preparing rehabilitation proposals to be voted on by the creditors.

As in a protective settlement procedure, debtors would be permitted to obtain financing or new loans during the rehabilitation process. If such loans are secured, a court's approval of the loans must be obtained before or after the confirmation of the protective settlement or the rehabilitation proposal. Approval by the court is not required for new unsecured loans.

— **Liquidation:** if the debtor is insolvent and there is no chance of conciliation through a protective settlement procedure or of rehabilitation because of, for example, a lack of enterprise value and operational efficiency, the court could initiate a liquidation process on its own initiative, or upon the request of the debtor, a creditor or the regulator of the debtor's activities. Under the Draft's proposed rules, insolvency would be determined by a simple cash flow test.

New loans can also be obtained during liquidation but must be approved by the creditors and the court, whether secured or unsecured, prior to the commencement of the liquidation process. It is worth noting that all new loans will be considered priority claims.

The Draft provides simplified models of the above-mentioned procedures designed for small entities with limited assets and allows creditors to benefit from set-off rights and debt netting arrangements. In addition, financial collateral will be exempt from the effects of insolvency, such as a stay of enforcement against creditors.

The Draft will be discussed and reviewed by the Saudi Bureau of Experts at the Council of Ministers, and is expected to be signed into law by the end of the first quarter of 2017.